



STATE BOARD OF EQUALIZATION

1020 N STREET, SACRAMENTO, CALIFORNIA  
(P.O. BOX 1799, SACRAMENTO, CALIFORNIA 95808)

(916) 445-1516

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December 19, 1977

No. 77/174

TO COUNTY ASSESSORS AND INTERESTED PARTIES:

ASSESSMENT OF HISTORICAL PROPERTY

1978 Lien Date Interest Rate Component

Historical property assessed under the provisions of Chapter 1040, 1977 Statutes (Sections 439, 439.1, 439.2, 439.3, and 439.4, California Revenue and Taxation Code) is subject to valuation by the capitalization of income method in a specified manner.

In accordance with Section 439.2, Revenue and Taxation Code, the Board is required to announce the current interest rate component which is equal to the effective rate on conventional mortgages as determined by the Federal Home Loan Bank Board. This yield rate is to be used as a component of the capitalization rate in the valuation of properties subject to Historical Properties Contracts for the 1978 lien date.

Based on our analysis of information from the Federal Home Loan Bank Board, the yield rate component to be used for the 1978 assessment year is 9.50 percent.

Applicable Appraisal/Assessment Procedures

Senate Bill 380 was signed into law on September 22, 1977. This bill is the enabling legislation of Proposition 7 approved by the electorate on June 8, 1977. It implements the following provisions regarding the appraisal of qualified historical property including land and improvements.

- (1) Amends Section 8, Article XIII, of the Constitution to provide that qualified historical properties subject to an historic properties contract are "enforceably restricted."
- (2) Adds Sections 439 through 439.4 to the Revenue and Taxation Code so that qualified historical properties under contract must be valued for property tax purposes by using only the capitalization of income method.
- (3) The capitalization rate used in the capitalization of net income will include components for yield, risk, and property tax. When improvements are present, a component for recapture will be added.

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- a. The yield (interest component) will be announced annually by the State Board of Equalization no later than September 1. The rate will reflect the current yield rate as found by the Federal Home Loan Bank Board. For the 1978 assessment year, the yield component is 9.5 percent.
  - b. The risk component is established by law:
    - 1) Owner-occupied single-family residences are to be valued by the capitalization of income method using a capitalization rate that contains a risk component of 4 percent.
    - 2) The risk component for all other qualified historical property is 2 percent.
  - c. The property tax component to be used is calculated by multiplying the tax rate by assessment ratio and dividing by 100 (rate x ratio ÷ 100).
  - d. When improvements are present, a recapture component equal to the reciprocal of the improvements remaining economic life will be used  $\left(\frac{1}{REL}\right)$ .
- (4) In order for a property to be valued according to Senate Bill 380, a contract must be signed, accepted, and recorded prior to the lien date of the tax year in which such value is to be assessed.
- (5) In the event that a notice of nonrenewal is filed by either the owner, the city, or the county, the property will be valued for property tax purposes as prescribed in Revenue and Taxation Code, Section 439.3. This is the "procedure" used in valuing land subject to a California Land Conservation Act contract for which a notice of nonrenewal has been filed except that the interest rate announced by the Board specifically for use in the valuation of historic property—not open-space land—must be used. (See Revenue and Taxation Code, Section 426 and page 65 of Assessors' Handbook Section 521A, Valuation of Open-Space Property.)

Criteria used to identify and establish the eligibility of historic property are contained in Section 5031 of the Public Resources Code. Pertinent sections are extracted from the Public Resources Code and printed in the California Property Tax Laws publication issued annually by this Board.

The Legislature has directed the State Board to submit a report by December 1980 evaluating the impact of this act. We request your assistance in complying with the Legislature's directive and ask that you keep informal records on the following subjects:

- (1) An inventory of properties valued pursuant to this act.
- (2) The types of properties (a) residential, (b) commercial, (c) recreational, and (d) other.
- (3) Annual (restricted) value and taxes applicable.
- (4) Special factors affecting participation in the act.
- (5) Recommendations to rectify inequities of the act.

Suggested Appraisal Techniques

The "capitalization of income method" referred to in Senate Bill 380 encompasses several capitalization techniques. The assessor should use the one that correctly considers the shape and duration of the income stream anticipated from the restricted use of the particular property. The following examples demonstrate (1) the direct capitalization of net income earned by an unimproved historical property, and (2) the capitalization of a level terminable income stream that might be anticipated by leasing an owner-occupied single-family residence.

We assume many historical properties will be well maintained and will continue to be of historical interest throughout their economic lives. Therefore, a straight-line declining income premise may be improper, and a level terminable income stream more reasonable. The estimated remaining economic life is an important consideration and should be researched thoroughly.

(1) Unimproved Historical Property

The enforceably restricted value of land subject to the historical property contract may be estimated by direct capitalization of net rent, i.e.,

Gross Income (fair rent, four acres @ \$100)	\$400
Expenses	<u>-16</u>
Net Income	\$384

Capitalization Rate:

Yield	.095 (State Board announced component)
Property Tax	.030 (Current tax component)
Risk	<u>.020</u> (Statutory risk component)
	.145

Capitalized Value:

$$\$384 \div .145 = \$2,400$$

(2) Improved Historical Property

The enforceably restricted value of improved historical property may be estimated by adding the present worth of the level, terminal net income anticipated from the use of the property as improved and the reversionary value of the land at the end of the improvements economic life. The total value estimate may be allocated to land and improvements respectively by using either the land or improvement residual technique. (Example--an owner-occupied single-family residence. Income reflects fair rent. Residence has a remaining economic life of 40 years.)

Gross Income (\$600 x 12 months) =	\$ 7,200
Vacancy and Collection Loss	<u>200</u>
Effective Gross Income	\$ 7,000
Expenses	<u>500</u>
Net Income	\$ 6,500

Capitalization Rate:

Yield	.095 (State Board announced component)
Property Tax	.030 (Current tax component)
Risk	.040 (Statutory risk component)

PW1/P @ 16.5 percent for 40 years = 6.0471

6.0471 x \$6,500 \$39,306

Reversionary Value of Land

PW1 @ 16.5 percent for 40 years = .0022

.0022 x \$8,000 estimated land value = \$ 18

\$39,324

Total Property Value (rounded) \$39,500

Allocation:

Land	\$ 8,000
Improvement	\$31,500

TO COUNTY ASSESSORS AND  
INTERESTED PARTIES

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Please direct any comments or questions regarding the appraisal and assessment of enforceably restricted historical property to John McCoy at (916) 445-4982.

Sincerely,

*Abram F. Goldman*

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Assistant Executive Secretary  
Property Tax Department

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